Joint Interim Committee
on
Automobile Dealers
and
Manufacturers

January 5, 2000

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The Honorable Edward Quick, President Pro Tem
The Honorable Steve Gaw, Speaker
State Capitol Building
Jefferson City, MO 65101

Dear Mr. President and Mr. Speaker:

The Joint Interim Committee on Automobile Dealers and Manufacturers, has met, taken testimony, deliberated and concluded its study on Automobile Dealers and Manufacturers. The undersigned members of the Committee are pleased to submit the attached report.

Senator Ken Jacob, Co-Chair

Representative Patrick O'Connor, Co-Chair

Senator Joe Maxwell

Representative Robert Hilgemann

Senator Ted House

Representative Don Koller

Senator Danny Staples

Representative Gracia Backer

Senator Betty Sims

Representative Cindy Ostmann

Senator Sarah Steelman

Representative Carson Ross

Senator Steve Ehlmann

Representative Ken Legan

REPORT OF THE JOINT INTERIM COMMITTEE ON AUTOMOBILE DEALERS AND MANUFACTURERS

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REPORT

The Committee held several meetings throughout the state and heard testimony from interested parties. Below is a list of meeting dates and locations:

September 24, 1999	St. Louis
October 8, 1999	Lake Ozark
October 22, 1999	Jefferson City
November 19, 1999	Jefferson City

The Missouri Motor Vehicle Franchise Practices Act governing new automobile dealership franchises was first enacted in 1980. This law was designed to address conditions prevalent during that period of time. Since that time, the conditions in the new automobile industry have changed dramatically. The Internet has begun to fill a role as receptionist, informing potential customers of the benefits and qualities of linemakes of cars, and referring them to an authorized dealership within an area of the customer's choosing. Conglomerate new automobile dealerships have also developed in recent years. These dealerships do many times over the volume of business, are more affluent and operate on an exponentially larger scale than the dealerships existing in 1980.

As a result of these changes, testimony revealed that at least two of the "Big Three" manufacturers have announced plans to wholly or partially own dealerships. Ford announced plans for factory owned dealerships in 1995, and have since purchased numerous dealerships in mainly metropolitan cities. In Salt Lake City, those purchases captured 6 of the 7 Salt Lake Ford dealerships, converting them to Ford owned dealerships competing with one independently owned Ford dealership. Ford currently has opened factory owned stores in five states. None of the states have prohibitions against factory owned dealerships. GM also had announced plans for factory stores. Due to independant dealers' complaints, GM rescinded their plans to wholly own dealerships on November 1, 1999. GM still plans to partially own dealerships. Neither Ford nor GM currently own, in whole or part, any dealerships in Missouri under the factory owned dealership plan.

It is difficult to speculate as to the impact factory owned dealerships will have on consumers. It will definitely affect dealers, but to what extent is indeterminable. The current law was not designed to regulate, account for or

otherwise govern factory owned dealerships. Moreover, the full impact of the Internet has not yet been realized. It is very possible that in the near future consumers may purchase new cars direct from the factory. In fact, testimony revealed that one advertisement on a web page for the Ford Auto Collection in Tulsa, Oklahoma, a factory owned dealership, already offered cars for sale over the Internet. Another example of the uncertainty is an advertisement by another factory-owned dealership which read, "factory-direct pricing". Factory ownership is making dealers extremely wary of competing with their suppliers, as these two examples show that factory owned dealerships are already using non-market based advantages to increase sales.

During the hearings, the dealers presented eighteen issues they felt needed to be addressed by legislation. Manufacturers gave both oral and written testimony in responding to the dealers' concerns. Both sides of the issues are presented below with a summary, an overview of perspectives, and a synopsis of applicable Missouri law.

1) **Factory ownership** Factory ownership is defined as the ownership of a dealership by a manufacturer. Dealers want restrictions placed on factory ownership. The dealers do not want to compete with manufacturers. They claim potential discrimination, reprisals and the end of dealership system. The manufacturers stated that factory stores are separate corporate entities and current law already prevents discrimination. Manufacturers also claimed that factory stores would promote distribution, unbundle services, and allow the manufacturers to experiment with consumer wants and revitalize inner cities. There is no Missouri law restricting factory ownership - however section 407.825, RSMo, prohibits discrimination, forced acceptance of unwanted cars and refusal to deliver ordered cars. On this issue, this statute would provide legal remedies if the independent dealers could prove preferential treatment by the manufacturer toward factory owned dealerships. This, apparently is nearly impossible to prove.

2) **Termination - stay of proceedings** During a proceeding to terminate a dealership, the dealership can be closed by the manufacturer during the appeals process. The dealers want a "stay" during court proceedings to continue their business. They claim that discontinuing the business reduces the sale price of a franchise. Manufacturers testified that any change is unnecessary, as only one Missouri dealership has been terminated in 5 years. Section 407.822.1, RSMo, provides for a stay during the administrative process, but not during court appeals.

3) **Arbitration** Arbitration is common in franchise contracts as a required dispute resolution system. Dealers want to prohibit required arbitration in franchise agreements. Manufacturers argue that arbitration is a contractual issue that should be allowed under general principles of freedom of contract. The state encourages arbitration, and contracts of adhesion[1] are already illegal under section 435.350, RSMo. Dealers' contracts are contracts of adhesion, none negotiated agreements.

4) **Written guidelines for termination** The dealers want uniform written criteria from the manufacturers addressing the general reasons a franchise can be terminated. Manufacturers state that this issue was already addressed in 1997 by section 407.825 which provides a standard to be met before termination. Manufacturers also state that a change is unnecessary, as only one dealer has been terminated in 5 years. Section 407.825.1(5), RSMo, states that a manufacturer cannot terminate any franchise unless franchisee substantially defaults in the performance of reasonable and lawful obligations under the franchise.

5) **Written guidelines for transfer** Dealers favor uniform written criteria from manufacturers on their guidelines for approving potential franchise buyers. The dealers would also like a fixed time limit for approval. Manufacturers state that current law is sufficient and there is no evidence of abuse. Section 407.825.1(7), RSMo, provides that a sale can be stopped by the manufacturer if the buyer fails to satisfy any standards which are normally relied upon by the franchisor, and relate to the management or ownership or to the qualification, capitalization, integrity or character and which are reasonable. However, there is no statutory time frame when a decision must be made. The section goes on to read, "A franchisee may request, at any time, that the franchisor provide a copy of the standards which are normally relied upon by the franchisor to evaluate a proposed sale or transfer and a proposed transferee".

6) **Choice of law** Choice of law is the ability by contract to determine which state's law should govern a dispute. For example "The laws of New York shall govern all disputes arising under this contract." Dealers want to prohibit choice of law clauses in franchise agreements. Manufacturers claim this is a freedom of contract issue. Section 407.820, RSMo, states that manufacturers are subject to jurisdiction of Missouri. A sample franchise agreement provides that all disputes will be governed by the

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[1]Contracts of adhesion are standardized form contracts where one party has little to no bargaining power.

laws of Michigan.

7) **Relevant market area** Relevant market area is a geographic determination of reasonably potential car buyers, for example if one Lexus dealer "covers" Jefferson City. Dealers would like an administrative complaint process when a same make dealer would move into their established relevant market area. They point out that they would be in a better position than the manufacturers to determine if the market area is already saturated before new dealerships are added. Manufacturers claim that it is not good business to overcrowd the market, thus their intent is not to add unnecessary dealerships. Manufacturers add that they need flexibility to serve consumers, and further regulation would increase costs to consumer. Adding such a process would also allow dealers to postpone or punish other competing dealers. There is no Missouri law on this subject.

8) **Relocation** When dealerships want to move locations, they must ask permission of the manufacturer. Dealers want manufacturers to be required to approve acceptable relocations per written guidelines. Manufacturers state that relocation is a business decision not suited for regulation, and is covered by current law. Section 407.827, RSMo, which applies only to St. Louis City, requires " reasonable efforts" for "equitable distribution" and to serve minorities. There is no general law applicable to this subject.

9) **First refusal** Under current law, when dealers consider selling their dealership, the manufacturers have a right to reject the buyer if they offer a deal the same or better than the rejected buyer. Dealers request this provision be deleted as manufacturers can control price and exert influence to punish dealers by making the dealership appear undesirable, or by postponing approval. The manufacturers also may "partner" linemakes, such that the Chevrolet portion of the dealership is required when selling the Oldsmobile portion, to dissuade potential buyers. Manufacturers assert that current law is sufficient and there is no evidence of abuse. First refusal also allows manufacturers flexibility in changing strategies and guaranteeing fair market value thus benefitting dealers. Section 407.825.1(7), RSMo, states that manufacturers have right of first refusal if it's in the franchise agreement and the dealer gets a same or better deal. There is no right of first refusal provided in family transfers, or for "qualified managers". The statute also provides that the manufacturer must pay expenses, including attorney fees, when exercising first refusal.

10) **Warranty reimbursement** Dealers are paid by manufacturers for work done to cars under warranty. Dealers want a shorter reimbursement time period, and clarification that reimbursement is at retail prices. Manufacturers state that regulating payments will increase cost and be passed on to the consumer. Manufacturers also claim that set reimbursement rates would provide incentive for dealers to raise rates. Section 407.583, RSMo, provides that dealers receive reimbursement at same rate for labor not under warranty. However, no time limit is specified. During testimony, it was revealed that Chrysler has implemented a policy that threatens dealers' "balance sheet when legislators attempt to manage [their company]" by setting their reimbursement rates. The apparent justification was the phrase reasonable compensation as used in the statute, "reasonable compensation for labor at a rate no less than that posted by the dealer for labor not under warranty."

11) **Warranty audits** Manufacturers can audit a dealer's warranty work for a period up to two years after the work was done pursuant to provisions of most franchise contracts. Dealers want this time period shortened to one year by statute, claiming that the audits are used as punishment and the extended time period does not allow for certainty or uniformity in their business. The manufacturers state that the two years is standard and allows them to discover unauthorized or illegal business practices on the part of manufacturers.

12) **Advertising** Advertising cost is currently a provision in most franchise contracts, requiring dealerships to share in the cost of related manufacturer advertising. The dealers would like the option to participate in manufacturer advertising, instead of the requirement imposed by most franchise contracts. The manufacturers did not respond directly to this issue. They offered help with misleading ad legislation. There is no Missouri law on this subject.

13) **Product defect indemnification** Product defect indemnification means that the manufacturer would be required to pay for any damages caused by a defective product and guarantee that the dealership would not be liable. The dealers want statutory language codifying this indemnification. Manufacturers claim that indemnification is provided for in sales and service contracts, and product liability law already applies. There is no Missouri law requiring a manufacturer to indemnify a dealer for manufacturing defects, however, product liability law may apply.

14) **Retroactivity** Dealers want any statutory changes applied retroactively. Manufacturers want the changes to apply prospectively. Manufacturers point out that it is not constitutional to change the terms of a contract. The actual language of any legislation would determine its application, but retroactive application of new law to contracts does raise questions of constitutionality. A law may be retroactively applied if it is reasonable and necessary to serve an important public purpose.

15) **Repurchase upon termination** Manufacturers are required to repurchase certain inventory items when a dealership closes. The dealers would like additional compensation for building and land costs. Manufacturers indicate that current law already provides for repurchase of inventory, parts, equipment, etc. pursuant to section 407.825.1(13), RSMo. This section provides for repurchase of inventory (etc), plus delivery cost, plus 5% on parts. However, there is no provision that the manufacturer pay for the land or building.

16) **Exclusivity** Exclusivity is the requirement that dealerships sell only one (or a few) linemakes. Dealers protest that manufacturers should not control which linemakes a dealer can or cannot sell. Manufacturers are concerned with clear image and strong brand identification. Manufacturers add that this also allows dealers to focus sales efforts through increased product knowledge, training and loyalty. Section 407.825.1(5)(a), RSMo, allows other linemakes if the non-exclusivity is established before 1997, otherwise non-exclusivity requires manufacturer's consent in writing.

17) **Captive finance companies** Many manufacturers have started subsidiary corporations that offer loans for the purchase of associated new vehicles. The dealers want restrictions on manufacturers controlling the financing of car sales. The manufacturers point out that these companies are separate corporate entities competing with other financial institutions, and are controlled by the laws governing financial companies. They argue that regulating these finance companies under the motor vehicle franchise law would disadvantage them in competing with other financial companies. There is no Missouri law on this subject.

18) **Civil Procedure** When disputes arise, current law provides for a hearing before the Administrative Hearing Commission. The procedures used during the hearing are provided by the AHC. The dealers want to add full discovery as a procedure for these hearings. Manufacturers point out that the hearing process has only been in effect since 1997 and very few cases

have been brought. They advocate giving the current law an opportunity to work. Pursuant to current law, there is no discovery available in administrative hearings although the AHC is allowed to promulgate rules regarding discovery. The AHC states that discovery would not be useful due to the current time constraints of granting a hearing within 45 days.

The dealers expounded upon this list of concerns during testimony. They focused on the uncertainty and the differences in bargaining power and economic strength between dealerships and manufacturers. One dealer related that he houses two different car manufacturer's lines, Volvo and Saab, in one dealership facility. He recently received a letter from Volvo stating they would like him to be an exclusive dealership selling only their cars. This would mean that he would either be forced to purchase another dealership facility to continue selling Saab, or cancel his contract with one of the manufacturers. After negotiations failed, Volvo threatened to cancel his contract if he did not stop selling Saab. The dealer is left in an uncertain and costly position.

Another dealer told of a letter he received from Chrysler concerning warranty reimbursement. As described above, dealers are to be reimbursed for warranty work at the same labor cost as non-warranty work. Chrysler interpreted the statute to mean they could determine what is the reimbursement rate. Chrysler further stated "While state dealer associations and legislatures have the right to propose and pass new legislation, we have the right to protect and preserve our balance sheet. Where and when appropriate, DaimlerChrysler Motors Corporation will not hesitate to institute new vehicle surcharges or equivalent measures in order to recover its costs." Again, the dealer is left to contemplate possible retribution if he complains.

A third dealer reported that manufacturers often intimidate dealers by using audits of warranty work records. One example given was the transmission in a newly designed car. After following the manufacturers written specifications, the transmission was still not working properly. The dealership technician phoned the manufacturer for help, but those suggestions also proved fruitless. Approximately 6 months later, the customers experience transmission problems again. This time the manufacturer suggests replacing the entire transmission assembly. Eighteen months later the dealership is audited for their warranty work. The audit forces the dealer to pay the manufacturer for its unnecessary repairs prior to replacing the entire assembly, even though all of those repairs were done according to the manufacturer's manual, and eventually instructed by the manufacturer technician. The dealer is left paying

for needless repairs that the manufacturer directed him to make.

Several dealers also described receiving letters from manufacturers stating their dealership was no longer viable, or demanding that the franchise agreement would be canceled upon the death of the current owner. Many related instances of manufacturers not delivering requested cars for inventory, or waiting periods of months for a customer ordered car. Other letters received from manufacturers described manufacturer's plans to reduce the total number of dealerships by approximately 20%. In Missouri, that translates into terminating approximately 108 of the state's 540 new car dealerships. The dealers are left without a transferrable business, or left to wonder if their dealership is targeted for downsizing.

Economically, a reduction of 108 dealerships in Missouri would approximate a loss of $216 million of payroll according to the National Automobile Dealers Association.[2] It is virtually impossible to calculate the impact to the state's tax base as it is unclear whether the manufacturers will buy any of the downsized dealerships, whether existing dealerships will become larger, or whether the combined effect will raise the price of cars thereby increasing sales taxes.

We know what the world is like with the current dealership system, but we do not know what the world will be like with factory ownership. Many states already have adopted legislation which restricts factory ownership.

One type of restriction on factory ownership is used by the state of Texas. There is a strict prohibition of factory ownership with only two exceptions. The first exception is "holding" a dealership that is being transferred from one owner to another for a period not to exceed 12 months. The second exception is co-ownership for minority diversification. In both cases, the administrative body is informed of all actions. In North Carolina, the exceptions include factory stores outside of the relevant market area of existing dealerships, factory stores existing prior to 1973, public interest in establishing a dealership in a desired area, or specific cases where there are limited numbers of line make dealerships. Florida has a mixture of the prohibitions and exceptions used by Texas and North Carolina. All three of these states extend their prohibitions to subsidiary corporations.

While 49 of 50 states have laws addressing some aspect of the manufacturer-dealer relationship, only 32 address manufacturer ownership of

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[2]NADA estimates a payroll of $2 million for the average dealership.

dealerships. Missouri currently falls into the 35% category with 18 other states that have no restriction and do not address the issue. Approximately 12 states prohibit it all together.

RECOMMENDATIONS

The Joint Interim Committee on Automobile Dealers and Manufacturers recommends Missouri's General Assembly address, legislatively, the following franchisor/franchisee issues:

1) A prohibition of factory owned, operated and/or controlled dealerships with exceptions;

2) The addition of language regarding relevant market areas, or area of sales responsibility, of Missouri's franchised dealerships as determined by their sales and service franchise agreements;

3) All aspects of warranty related issues including claims, audits and reimbursements and the time frames governing the same;

4) The desire of dealerships to invest in additional franchises in order to represent a variety of vehicles and products to their customers, and their additional desire to continue to represent current multiple franchises and products at their exiting retail facilities, a.k.a. "dualing" and "exclusivity";

5) Civil procedure aspects to cleanup some problems with the Administrative Hearing Commission; and

6) In consideration of the above recommendation, the General Assembly should consider the interests of the consumer.

Exhibit A

MISSOURI SENATE

DIVISION OF RESEARCH

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A:\FINREPRT.99

TO: Joint Committee on Auto Dealers and Manufacturers

FROM: Charles Hatcher, Staff Attorney

DATE: November 17, 1999

RE: Auto franchise committee

Below is a quick reference table which outlines the dealers' concerns, the manufacturers' response and applicable Missouri law.

Issue	Dealers' view	Manufacturers' view	Missouri law
Factory ownership	Don't want to compete with manufacturers. Claim discrimination, reprisals and end of dealership system.	Factory stores are separate entities and current law already prevents discrimination. Factory stores also promote distribution, unbundle services, experiment with consumer wants and revitalizing inner cities.	There is no Missouri law restricting factory ownership - however **407.825** prohibits discrimination, forced acceptance of unwanted cars and refusal to deliver ordered cars.
Termination - stay of proceedings	Want "stay" during court proceedings to continue dealership. Discontinuing it reduces sales price of franchise.	Unnecessary, as only one Missouri dealer terminated in 5 years.	**407.822.1** -- Provides stay, but only during administrative process, not court appeals.
Arbitration	Want to prohibit required arbitration in franchise agreements.	Freedom of contract.	The state encourages arbitration, and contracts of adhesion* are already illegal under **435.350**.

Written guidelines for termination	Want uniform written criteria for man. to terminate a franchise.	Already addressed in 1997. Unnecessary, as only one dealer terminated in 5 years.	**407.825.1(5)** -- Man. cannot terminate any franchise unless franchisee substantially defaults in the performance of reasonable and lawful obligations under the franchise.
Written guidelines for transfer	Want uniform written criteria for man. to approve/deny potential franchise buyers with time limits.	Current law is sufficient and there is no evidence of abuse.	**407.825.1(7)** -- A sale can be stopped by the man. if the buyer fails to satisfy any standards which are normally relied upon by the franchisor, and relate to the management or ownership or to the qualification, capitalization, integrity or character and which are reasonable. However, there are no time limits. **407.825.1(7)** - "A franchisee may request, at any time, that the franchisor provide a copy of the standards which are normally relied upon by the franchisor to evaluate a proposed sale or transfer and a proposed transferee".
Choice of law**	Want to illegalize choice of law in franchise agreements.	Freedom of contract.	**407.820** -- Manufacturers are subject to jurisdiction of Missouri.
Relevant market area	Want administrative complaint process when a same make dealer would move into area.	It is not good business to overcrowd the market. Man. need flexibility to serve consumers, and further regulation would increase costs to consumer. Also allows dealers to postpone or punish other competing dealers.	There is no Missouri law on this subject.
Relocation	Want manufacturers to be required to approve acceptable relocations per written guidelines.	Freedom of contract, is a business decision not suited for regulation, and is covered by current law.	**407.827** -- Applies only to St. Louis City requiring " reasonable efforts" for "equitable distribution" and to serve minorities.

First refusal	Delete this provision as man. can control price and exert influence to punish dealers. Also allows for "partnering" of linemakes to dissuade potential buyers.	Current law is sufficient and there is no evidence of abuse. Also allows man. flexibility in changing strategies and guaranteeing fair market value thus benefitting dealers.	**407.825.1(7)** -- Man. have right of first refusal if it's in the agreement and dealer gets same or better deal. There is no first refusal for in family transfers, or "qualified managers". Also, the man. must pay expenses, including atty fees, when exercising first refusal.
Warranty reimbursement	Want a shorter reimbursement time period at retail prices.	Regulating payments will increase cost and be passed on to consumer. Provides incentive for dealer to raise rates.	**407.583** -- Dealers receive reimbursement at same rate for labor not under warranty. However, no time limit is specified.
Advertising	Want option to participate in man. advertising - can be currently required by contract.	Did not respond - offered help with misleading ad legislation.	There is no Missouri law on this subject.
Product defect indemnification	Want statutory language indemnifying dealers.	Already provided for in sales and service contracts, and product liability law already applies.	There is no Missouri law requiring a manufacturer to indemnify a dealer for man. defects. Product liability law may already apply.
Retroactivity	Want any changes applied retroactively.	Changes should apply prospectively, and it is not constitutional to change terms of a contract.	Doubted constitutionality, but can be retroactively applied if it is reasonable and necessary to serve an important public purpose.
Repurchase upon termination	Want compensation for building/land costs when the dealership is terminated.	Current law already provides for repurchase of inventory, parts, equipment, etc.	**407.825.1(13)** -- Provides for repurchase of inventory (etc), plus delivery cost, plus 5% on parts. However, there is no provision that the man. pay for the land.
Exclusivity	Man. should not control linemake of cars a dealer can sell.	Concerned with clear image and strong brand identification. Also allows dealers to focus sales efforts through increased product knowledge, training and loyalty.	**407.825.1(5)(a)** -- Allows other linemakes if established before 1997, otherwise requires man. consent in writing.
Captive finance companies	Want restrictions on manufacturers controlling the financing of car sales.	These companies are separate entities competing with other fin. institutions. Motor vehicle admin law would disadvantage them. Other remedies exist that apply to other fin. institutions.	There is no Missouri law on this subject.

Civil Procedure	Want discovery for admin. hearings.	Current law should be given opportunity to work.	There is no discovery available in admin hearings - AHC claims due to time constraints.

* contracts of adhesion: standardized form contract where one party has little to no bargaining power.

** choice of law: ability by contract to determine what state's law should govern a dispute. For example "The laws of New York shall govern all disputes arising under this contract."